

*United States Court of Appeals
for the Second Circuit*



APPELLEE'S BRIEF

Signed

74-2166

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

B

P/S

HOWARD M. WERNER,

Plaintiff-Appellant

v.

UNITED STATES OF AMERICA,

Defendant and Third-Party
Plaintiff-Appellee

v.

HUGO BUA, FRANK ALESI and ROBERT SMITH,

Third-Party Defendants

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLEE



SCOTT P. CRAMPTON,
Assistant Attorney General,

GILBERT E. ANDREWS,
MICHAEL L. PAUP,
JEFFREY S. BLUM,

Attorneys,
Tax Division,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

PETER C. DORSEY,
United States Attorney,

HENRY S. COHN,
Assistant United States Attorney.

TABLE OF CONTENTS

	Page
Statement of the issue presented-----	1
Statement of the case-----	2
Summary of argument-----	7
Argument:	
The District Court correctly determined that taxpayer was a person responsible for withholding and paying over taxes deducted from the wages of employees of Hugo's restaurant during the third and fourth quarters of 1967-----	9
Conclusion-----	20
Appendix-----	21

CITATIONS

Cases:

<u>Adams v. United States</u> , 504 F. 2d 73 (C.A. 7, 1974)-----	15, 17
<u>Bloom v. United States</u> , 272 F. 2d 215 (C.A. 9, 1959)-----	10
<u>Botta v. Scanlon</u> , 198 F. Supp. 894 (S.D. N.Y., 1961), aff'd, 314 F. 2d 392 (C.A. 2, 1963)-----	10, 11
<u>Braden v. United States</u> , 442 F. 2d 342 (C.A. 6, 1971), cert. denied sub nom. <u>Bonistall v. Braden</u> , 404 U.S. 912 (1971)-	18
<u>Burack v. United States</u> , 461 F. 2d 1282 (Ct. Cl., 1972)-----	18
<u>Dillard v. Patterson</u> , 326 F. 2d 392 (C.A. 5, 1963)-----	9
<u>Flora v. United States</u> , 357 U.S. 63 (1958), aff'd on rehearing, 362 U.S. 145 (1958)-	10
<u>Genis v. United States</u> , 489 F. 2d 95 (C.A. 5, 1974)-----	10, 17
<u>Harrington v. United States</u> , 34 A.F.T.R. 2d 6082 (C.A. 1, Oct. 24, 1974)-----	18
<u>Hill v. United States</u> , 368 F. 2d 617 (C.A. 5, 1966)-----	16
<u>Horwitz v. United States</u> , 339 F. 2d 877 (C.A. 2, 1965)-----	10
<u>Kalb v. United States</u> , 595 F. 2d 506 (C.A. 2, 1974)-----	11
<u>Liddon v. United States</u> , 448 F. 2d 509 (C.A. 5, 1971), cert. denied, 496 U.S. 918 (1972)-----	17
<u>Monday v. United States</u> , 421 F. 2d 1210 (C.A. 7, 1970), cert. denied, 400 U.S. 821 (1970)-----	10, 11
<u>Mueller v. Nixon</u> , 470 F. 2d 1348 (C.A. 6, 1972)-----	14, 15, 17

Cases (continued):

Page

<u>National Research Bureau, Inc. v.</u>	
<u>Bartholomew, 482 F. 2d 386</u>	11
(C.A. 3, 1973)-----	
<u>Newsome v. United States, 431 F. 2d 842</u>	
(C.A. 5, 1970)-----	10, 16, 17
<u>Pacific National Insurance v. United</u>	
<u>States, 422 F. 2d 26 (C.A. 9, 1970),</u>	
cert. denied, 398 U.S. 937 (1970),	
rehearing denied, 400 U.S. 883 (1970)---	
<u>Spivak v. United States, 254 F. Supp. 517</u>	
(S.D. N.Y., 1966)-----	11
<u>Spivak v. United States, 370 F. 2d 612</u>	
(C.A. 2, 1967)-----	10
<u>Stake v. United States, 347 F. Supp. 823</u>	
(Minn., 1972)-----	16, 17, 19
<u>Walker v. United States, 24 A.F.T.R. 2d</u>	
<u>5661 (N.D. Ga., 1969), aff'd per curiam,</u>	
<u>438 F. 2d 127 (C.A. 5, 1971)</u> -----	17
<u>White v. United States, 372 F. 2d 513 (Ct.</u>	
<u>Ct., 1967)</u> -----	10

Statutes:

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 3102-----	9, 21
Sec. 3402-----	9, 21
Sec. 6671-----	10, 21
Sec. 6672-----	9, 22
Sec. 7501-----	9, 22

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-2166

HOWARD M. WERNER,

Plaintiff-Appellant

v.

UNITED STATES OF AMERICA,

Defendant and Third-Party
Plaintiff-Appellee

v.

HUGO BUA, FRANK ALESI and ROBERT SMITH,

Third-Party Defendants

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLEE

STATEMENT OF THE ISSUE PRESENTED

Whether the District Court correctly determined that taxpayer
was a person responsible for withholding and paying over taxes
deducted from the wages of employees of Hugo's restaurant for
the third and fourth quarters of 1967.

STATEMENT OF THE CASE

Howard M. Werner (hereinafter taxpayer) brought this tax refund suit in the United States District Court for the District of Connecticut seeking to recover from the United States of America \$100 which he had paid pursuant to an assessment of a 100 percent penalty for willfully failing to pay Federal Insurance Contributions Act taxes and withholding taxes totaling ^{1/} \$11,975.50. (R. 1-3.) These taxes had been withheld from the wages of employees of Hugo's restuarant during the third and fourth quarters of 1967 and the first and second quarters of 1968. (R. 5.) The United States filed a counterclaim against taxpayer for the balance of the assessment and also filed third-party complaints against Hugo Bua, Frank Alesi and Robert Smith. (R. 4-6, 8, 20.) The third-party complaints alleged that Bua, Alesi and Smith were jointly and severally liable for portions of the tax arrears and sought (1) judgment against Smith for \$9,045.59 for taxes withheld during the third and fourth quarters of 1967, (2) judgment against Alesi for \$3,876.36 for taxes withheld during the third quarter of 1967, and (3) judgment against Bua for \$7,287.88 for taxes withheld during the third quarter of 1967 and the first and second

1/ "R." references are to Part A of the separately bound record appendix. "Tr." references are to Part B of the separately bound record appendix, containing portions of the transcript of testimony in the court below.

quarters of 1968. A default judgment entered December 7, 1972, in the amount of \$7,387.88 was obtained against Hugo Bua.

(R. 8, 17, 19.) Based on its Memorandum of Decision of April 17, 1974, the District Court (Honorable M. Joseph Blumenfeld) (1) dismissed taxpayer's complaint against the United States; (2) entered judgment in favor of the United States against taxpayer in the amount of \$9,045.59 for failure to pay taxes in the third and fourth quarters of 1967, but dismissed the balance of the United States' counterclaim for \$2,829.91 for taxes withheld during the first and second quarters of 1968; (3) dismissed the United States' claims against Smith and Alesi, and (4) on April 24, 1974, entered judgment in favor of Alesi against the United States for \$601.61. (R. 17, 21.) Taxpayer timely filed his notice of appeal on May 17, 1974. (R. 21.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

The pertinent facts, as found by the District Court, may be summarized as follows:

Hugo Bua was employed during 1966 and 1967 at a restaurant owned by Hugo's Continental Inc. (hereinafter the corporation). (Tr. 10.) During the early part of 1967, Bua approached a Mr. Kerin seeking financial assistance in the purchase of all the stock of the corporation. (Tr. 10.) Kerin enlisted taxpayer and Mr. Kaplan and, acting as joint venturers, these three provided Bua with the financial backing to purchase the stock. (Tr. 10.) The funds advanced to Bua by KKW, as the

Joint venture was informally known, were secured by a mortgage on Bua's home. (R. 10.) KKW also provided operating funds for the corporation by endorsing the corporation's notes, totaling over \$27,000, to two banks. (R. 10.) In return for KKW's backing, Bua gave KKW an option to acquire 51 percent of the stock in the corporation for \$1,000 at any time within two years from Bua's purchase of the corporation. (Tr. 10.)

At the time Bua acquired the corporation, the restaurant had over \$29,000 in outstanding liabilities, but KKW felt that Bua could make the restaurant a financial success. (R. 10.) This was not the case, however, and during May of 1967, the taxpayer began to involve himself actively in the affairs of the corporation. (R. 10.) At taxpayer's instigation, Frank Alesi and Robert Smith were brought into the restaurant as entertainers. (R. 10.) During the summer of 1967, taxpayer became more involved in the day-to-day management of the corporation, stopping in the restaurant almost every day after work to discuss the business with Bua and to advise Bua on the conduct of the business. (R. 10.) Eventually, taxpayer had Alesi and Smith act as assistant managers of the restaurant. (R. 10.)

During November of 1967, taxpayer had an audit conducted of the corporation's books in order to determine its financial position as of October 31, 1967. (R. 10-11.) The audit revealed that the corporation was still deeply in debt and that over \$9,000 was owed in withholding taxes through the first ten

months of 1967. (R. 11.) Taxpayer was very upset by the results of the audit and by the continued drain imposed by the corporation on the resources of KKW, which apparently had extended credit to the corporation since the initial backing of Bua. (R. 11.) A meeting was held to discuss the audit results and, at taxpayer's direction, the management of the restaurant was reorganized, giving Smith greater responsibilities and eliminating Bua's power to write checks on the corporate account. (R. 11; Tr. 59.)

Bua, an alien, was worried that he would be deported for failure to pay the taxes which were due. (Tr. 12.) Taxpayer testified that in order to alleviate this concern, KKW gave the corporation about \$11,500 on November 21, 1967, in return for an assignment of approximately \$12,500 of the corporation's accounts receivable. (Tr. 12, 13; R. 11.) At taxpayer's direction, Bua and Smith visited the local Internal Revenue Service office and were advised there that they would be contacted about the corporation's back taxes at a later date. (R. 11.)

Ultimately, only \$1,300 of the \$11,500 the corporation received in November, 1967, was paid to the Internal Revenue Service. At taxpayer's direction, the remainder was applied in satisfaction of other debts, including state taxes and liquor bills which taxpayer particularly wanted paid to avoid a suspension of the corporation's liquor license. (R. 11-12.)

After an unsuccessful Christmas holiday season, the principals of KKW met on New Year's Eve at the restaurant.

(R. 12.) Bua became enraged at his being excluded from the meeting and ejected the principals from the premises. (R. 12.) Subsequently, Bua resumed management of the restaurant and the taxpayer never again entered the restaurant. (R. 12.) Nevertheless, KKW, through the taxpayer, sought to have Bua repay KKW for its investment. Eventually Bua and KKW reached an agreement on March 15, 1968. (R. 12.) The agreement provided that KKW would assign the accounts receivable it had earlier acquired from the corporation back to the corporation and that Bua would acknowledge a debt to KKW of \$30,000, plus the value of the uncollected accounts receivable. (R. 12.) The agreement further provided that it constituted a consolidation of all previous obligations owed by Bua to KKW and that KKW agreed not to exercise its option to acquire the corporation's stock. (R. 12.) Bua also signed a note which required him to pay \$200 per week toward the amount which he owed KKW. (R. 12.) Bua made several of these payments before the corporation collapsed. (R. 12.)

Subsequently, the United States assessed against taxpayer a 100 percent civil penalty totalling \$11,975.50 in lieu of the taxes withheld from the employees of the restaurant. (R. 7.) Taxpayer paid \$100 of the assessment and filed a claim for refund which was denied. (R. 3, 7.) Taxpayer then brought this suit and the United States counterclaimed for the remainder of the

assessment. (R. 7-8.) The District Court held that taxpayer was a person responsible for the payment of withholding taxes during the third and fourth quarters of 1967 and entered judgment for the United States in the amount of \$9,045.59. (R. 13, 21.)

From this adverse decision the taxpayer appeals.

SUMMARY OF ARGUMENT

Section 6672 of the Internal Revenue Code of 1954 provides that any person who is required to collect, account for and pay over taxes and who willfully fails to do so is subject to a penalty equal to the amount of the tax not collected, accounted for or paid over. As the courts have consistently held, the provisions of Section 6672 were directed toward holding those individuals within an organization who have the final word as to what bills or creditors should be paid personally accountable for the decisions they make. If such a responsible person exercises his authority so that the organization pays its obligations to other creditors in preference to meeting its obligations to the United States for withheld taxes, that responsible person may be held personally liable for the tax arrearages attributable to his decisions. A responsible person within the meaning of Section 6672 is not invariably the one who prepares the tax return, keeps the books and records, or pays the wages. Indeed, an entity or person need not necessarily even be an officer or employee of the corporation to be a responsible person. All that is required by the statute is that a person have the final word as to which creditors shall be paid.

Taxpayer here clearly was a responsible person within the meaning of Section 6672. As a member of a joint venture which

provided the corporation with substantial financial backing and could at any time acquire a controlling interest in the corporation for only a nominal amount, taxpayer actively monitored the corporation's affairs and determined which of the corporation's bills should be paid. Ultimately he directed that funds be applied in satisfaction of liquor bills and back state taxes rather than federal withholding tax obligations.

In so doing taxpayer acted as more than a mere creditor. The fact that he was nominally a creditor does not, contrary to his assertions, operate completely to shield him from liability under Section 6672. When he assumed a more active role than that of mere creditor, he lost whatever protection his creditor status gave him. It is quite clear that when a creditor assumes direct financial control of his debtor's business, as taxpayer here did, he becomes subject to the provisions of Section 6672, much the same as any other responsible officer in the debtor's business.

Finally, taxpayer has no basis upon which to complain of the amount for which he was held liable under the District Court's judgment. After taxpayer assumed financial control of the corporation, he ascertained the exact amount of the corporation's withholding tax arrearages. With full knowledge of these arrearages, taxpayer proceeded to direct that corporate funds well in excess of that withholding tax liability be paid to creditors other than the United States. Taxpayer's actions here thus fully justify holding him liable for the full amount of the corporation's withholding tax liabilities accrued before and during the time he was a responsible person within the meaning of Section 6672.

ARGUMENT

THE DISTRICT COURT CORRECTLY DETERMINED THAT TAXPAYER WAS A PERSON RESPONSIBLE FOR WITHHOLDING AND PAYING OVER TAXES DEDUCTED FROM THE WAGES OF EMPLOYEES OF HUGO'S RESTAURANT DURING THE THIRD AND FOURTH QUARTERS OF 1967

Section 6672 of the Internal Revenue Code of 1954, Appendix, infra, provides that any person who is required to collect, account for and pay over taxes and who willfully fails to do so is subject to a 100 percent penalty equal to the amount of the tax not collected, accounted for or paid over. The intent of Congress in enacting this provision is clear. Sections 3102 and 3402 of the Internal Revenue Code of 1954, Appendix, infra, require every employer to withhold federal income and social security taxes from the wages of their employees. The amounts withheld constitute a special trust fund for the United States. Section 7501, Internal Revenue Code of 1954, Appendix, infra. Where an employer has withheld a tax but failed to pay it over to the United States, the employee is credited with the amount withheld and no additional payment is required. Unless the Government has recourse for collection of the tax from either the employer or the responsible agent of the employer, the tax will be lost. Dillard v. Patterson, 326 F. 2d 392 (C.A. 5, 1963). Thus, in enacting Section 6672, Congress was solely interested in protecting the revenue by permitting collection from those responsible persons who caused the diversion as well as from

the corporation which used the funds for its own purposes.

Spivak v. United States, 370 F. 2d 612 (C.A. 2, 1967). This case presents the question whether taxpayer was a responsible person within the meaning of Section 6672.^{2/}

The courts have recognized that a responsible person, within the meaning of Section 6672, is one who has the final word as to which bills or creditors should be paid and when.

Horwitz v. United States, 339 F. 2d 877 (C.A. 2, 1965); Bloom v. United States, 272 F. 2d 215 (C.A. 9, 1959); Monday v. United States, 421 F. 2d 1210 (C.A. 7, 1970), cert. denied, 400 U.S. 821 (1970); Newsome v. United States, 431 F. 2d 842 (C.A. 5, 1970). Thus, it is not necessary that a responsible officer be the one who has prepared the tax return, kept the books and records or paid the wages. White v. United States, 372 F. 2d 513 (Ct. Cl., 1967); Genis v. United States, 489 F. 2d 95 (C.A. 5, 1974). Indeed, while Section 6671(a), Appendix, infra, defines a "person" in this context to include "an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty" to pay over withheld taxes, an entity or person need not even be an officer

^{2/} While the full payment rule of Flora v. United States, 357 U.S. 63 (1958), aff'd on rehearing, 362 U.S. 145 (1958), is not applicable to refund suits involving 100 percent penalties under Section 6672, a taxpayer must pay the tax for one employee for one quarter before bringing the refund suit. Botta v. Scanlon, 198 F. Supp. 894 (S.D. N.Y., 1961), aff'd on other grounds, 314 F. 2d 392 (C.A. 2, 1963). Taxpayer here failed to allege that he had done so, however, and this would apparently have been sufficient cause to dismiss his suit. However, the Government's counterclaim had an independent jurisdictional basis. Therefore, (continued)

or employee of the corporation to be a responsible person. So long as he has final word as to who shall be paid, a person qualifies as a "responsible" person under Section 6672. Pacific National Insurance v. United States, 422 F. 2d 26, 30 (C.A. 9, 1970), cert. denied, 398 U.S. 937 (1970), rehearing denied, 400 U.S. 883 (1970); cf. Botta v. Scanlon, 314 F. 2d 392 (C.A. 2, 1963). In order for the requisite "willfulness" to be found, there is no need to find evil motive or specific intent to deprive the Government of revenue; "reasonable cause" or "justifiable excuse" are irrelevant in this context. All that is required is that the responsible person pay creditors other than the United States, knowing that amounts were then due to the United States. Monday v. United States, supra, 421 F. 2d, p. 1216; Kalb v. United States, 505 F. 2d 506 (C.A. 2, 1974).

Taxpayer clearly was a responsible person within the meaning of Section 6672. He was a member of KKW, a joint venture which had provided Bua, Hugo's nominal owner, with the funds necessary to purchase the restaurant corporation. In return for this loan, Bua had given the joint venture an option, exercisable within two years, to purchase a controlling interest in the restaurant corporation for \$1,000. (R. 10.) The joint venture's interest in Hugo's restaurant (and, indirectly, taxpayer's interest as well) was then considerably more extensive than that of an

^{2/} this Court, at the minimum, has jurisdiction over the taxpayer's appeal from the judgment below as to that counterclaim. Spivak v. United States, 254 F. Supp. 517 (S.D. N.Y., 1966), aff'd on other grounds, 370 F. 2d 612 (C.A. 2, 1967); National Research Bureau, Inc. v. Bartholomew, 482 F. 2d 386 (C.A. 3, 1973).

ordinary creditor. In turn, taxpayer's involvement in the day-to-day operations of the restaurant was also more extensive. As a member of KKW, taxpayer actively monitored the corporation's affairs. (R. 14.) This monitoring of the corporation's affairs eventually led to his determining which of the corporation's bills should be paid. Taxpayer advised Smith, a musician placed by taxpayer in an administrative position during October of 1967, how to proceed regarding the creditors of the corporation. (Tr. 23-24.) Smith would call taxpayer at his office to determine what to tell creditors or taxpayer would talk to the creditor himself. (Tr. 26.) Taxpayer directed Smith to pay certain creditors. (Tr. 30-32.) Ultimately, he directed that corporate funds which would have been more than sufficient to meet Hugo's federal withholding liabilities be applied in satisfaction of liquor bills and back state taxes rather than federal withholding tax obligation. (R. 11.)

Indeed, taxpayer does not even deny that he directed that corporate funds be applied to debts owed to others rather than to meet federal withholding tax liabilities. (Br. 4, 5.) In our view, this concession amounts to a concession of his case.

Pacific National Insurance v. United States, 422 F. 2d 26 (C.A. 9, 1970). However, taxpayer argues that Section 6672 is not applicable to one in his position. He urges that he was a mere creditor and argues that Congress did not intend to cloak a creditor with the liability of Section 6672. (Br. 14-15.) The facts which he here concedes are true effectively rebut his

argument. As we have already shown (and taxpayer in essence concedes), he was considerably more to the corporation than a mere creditor. He, through his joint venture, held an option to acquire an ownership interest in the corporation and throughout acted as though he had already acquired such an ownership interest. It was, as he concedes, he who "directed" the payment of creditors other than the United States. He did this at a time when the corporation had more than enough assets to meet its liabilities for all its arrearages in withholding taxes. And he did it with concededly full knowledge of those arrearages. In essence, then, taxpayer's argument boils down to an assertion that, even though he was in every other respect a responsible person acting willfully within the meaning of Section 6672, because his status was nominally that of creditor he cannot be held liable under the statute. That position cannot be sustained.

It is now well settled that the fact that one is nominally a creditor of a defaulting corporation, rather than a corporate executive, does not necessarily shield him from liability under Section 6672. In Pacific National Insurance v. United States, 422 F. 2d 26 (C.A. 9, 1970), the taxpayer was a corporate surety which exercised complete dominion and control over funds belonging to an employer and determined which creditors were to be paid. The employer could not pay out funds without the surety's permission. The Ninth Circuit rejected taxpayer's contention that it was not a person within the meaning of Section 6672 (pp. 30, 31):

* * * it is our conclusion that the language of these provisions is broad enough to reach an entity which assumes the function of determining whether or not an employer will pay over taxes withheld from its employees; * * * this reading of the language serves the evident purpose of the statute; * * *.

* * *

* * * it is evident from the face of * * * [Section 6672] that it was designed to cut through the shield of organizational form and impose liability upon those actually responsible for an employer's failure to withhold and pay over the tax. It would frustrate this purpose needlessly to imply a condition limiting the application of the section to those nominally charged with controlling disbursements of a corporate employer, thus immunizing those who, through agreement with or default of those nominally responsible, have exercised this corporate function in fact.

Thus, in its role as a lender, Pacific had exercised such control over the debtor's financial affairs during the tax periods in issue that it was held to have become a person responsible for the debtor's failure to pay over taxes withheld from the wages of the debtor's employees.

Similarly, in Mueller v. Nixon, 470 F. 2d 1348 (1972), the Sixth Circuit followed Pacific National and held that an officer of a lending institution, which received an assignment of the employee's accounts receivable, could be a person for purposes of Section 6672 if he had knowledge of the tax delinquency and authority over the decision of whether to pay taxes. In reaching this conclusion the court rejected the proposition which taxpayer presents here (Br. 14-15), that a creditor should not be subject to Section 6672 if he prefers

creditors over the United States in order to help a business survive. As the Sixth Circuit stated in Mueller (p. 1351)--

The tax sums involved in this proceeding, however, are all definite amounts which have been withheld from employees' wages in trust for the United States government. Absent stringent measures to protect these funds, they might easily be available to finance a business which was in a hazardous or failing condition. In our judgment Congress intended to prevent this.

Finally, in Adams v. United States, 504 F. 2d 73 (1974), the Seventh Circuit reversed a summary judgment entered in favor of a creditor which the Government had asserted was a responsible person under Section 6672. The court noted that (504 F. 2d, pp. 75-76)--

The "person" who is responsible for the payment of corporate taxes within the meaning of §6672 is that individual who has the final word as to what bills should or should not be paid, and when. Turner v. United States, 423 F. 2d 448, 449 (9th Cir. 1970). In this context, the word "final" means significant rather than exclusive control over the disbursal of funds. Dudley v. United States, 428 F. 2d 1196, 1201 (9th Cir. 1970). Moreover, although the liability for failure to collect, account for, and pay over withheld taxes usually attaches to those high corporate officials who have the power and responsibility within the corporate structure for seeing that taxes withheld from various sources are remitted to the government, Monday v. United States, 421 F. 2d 1210, 1214 (7th Cir. 1970), the party subject to the penalty for the corporation's failure to pay the taxes due is not always or necessarily an official of the delinquent corporation. McCarthy v. United States, 437 F. 2d 961, 967, 194 Ct. Cl. 43 (1971). The fact of the matter is that the responsibility for nonpayment of the tax includes all those so connected with the business as to be responsible for the performance of the act in respect of which the violation occurs. Dudley, supra,

428 F. 2d at 1201. Indeed, §6672 is broad enough to reach an entity which assumes the function of determining whether or not the employer will pay over taxes withheld from its employees. Pacific National Insurance v. United States, 422 F. 2d 26, 30 (9th Cir. 1970).

Therefore, the court concluded, since there was a factual dispute as to the creditor's involvement in the operations of the defaulting corporation, the Government was entitled to a trial to determine whether the creditor had exercised such powers as would render it a responsible person within the meaning of Section 6672. Quite clearly, in the Seventh Circuit's view, a creditor could be a responsible person under Section 6672. Accord, Newsome v. United States, 431 F. 2d 742 (C.A. 5, 1970); Stake v. United States, 347 F. Supp. 823 (Minn., 1972). In light of these cases, taxpayer's incorrect statement that (Br. 14) "Cases holding a creditor liable under Section 6672 are rare or non-existent" amply demonstrates the weakness of his argument.

^{3/} While Hill v. United States, 368 F. 2d 617 (C.A. 5, 1966), might be cited for the proposition that a creditor ought not to be held a responsible person within the meaning of Section 6672, we believe that Hill is distinguishable from the instant case and is, moreover, wrong in its analysis and, in light of subsequent appellate decisions, should be narrowly interpreted. In Hill employees of a bank and surety company had veto power over checks drawn by a debtor, and loans made by the bank and guaranteed by the surety were conditioned on the proceeds not being used to pay taxes. In affirming the District Court's granting of judgment n.o.v. for the bank and surety company, the Fifth Circuit held that neither the bank nor the surety exercised control over the debtor's internal affairs. That, of course, is clearly not the case here. (continued)

Nor should any weight be given to taxpayer's contention that he should not be held liable for the taxes withheld during the third quarter of 1967 since he was not aware of the corporation's outstanding tax liability until the fourth quarter of that year. (Br. 11.) All that is necessary for taxpayer to be liable under Section 6672 is that, knowing of arrearages owing to the Government, he prefers other corporate creditors over the United States. It is simply not pertinent whether taxpayer was a responsible person at the time the tax obligation originally arose. If he knew of the corporation's previously accrued liabilities and, even though he had corporate funds with which to meet those liabilities, chose instead to pay other corporate creditors, he may be held liable under Section 6672 for the full amount of those previously accrued liabilities.

Stake v. United States, supra; cf: Newsome v. United States, supra; Walker v. United States, 24 A.F.T.R. 2d 5661 (N.D. Ga., 1969), aff'd per curiam, 438 F. 2d 127 (C.A. 5, 1971).

The fact that taxpayer did not perform the ministerial function of collecting the tax or keeping the corporate books is also unimportant. Taxpayer contends that Bua was responsible

³⁷ The court in Hill also seems to have indicated a belief that Congress did not intend to extend Section 6672 liability to lenders. This analysis was based, however, upon legislative history arising, not under Section 6672, but under other sections which deal exclusively with an employer's primary liability to collect and pay over withholding taxes. The Fifth Circuit may, however, have abandoned its narrow interpretation of Section 6672. Liddon v. United States, 448 F. 2d 509, 512 (1971), cert. denied, 496 U.S. 918 (1972), and Genis v. United States, supra. That interpretation is quite clearly at odds with the better reasoned interpretations of the Ninth Circuit in Pacific National supra, the Sixth Circuit in Mueller, supra, and the Seventh Circuit in Adams, supra, and ought not to be adopted here.

for performing the ministerial functions of collecting the taxes and keeping the corporate books so that Bua should be regarded as the responsible officer. Yet the First Circuit has recognized (Harrington v. United States, 34 A.F.T.R. 2d 6082, 6085, 6088 (Oct. 24, 1974) that--

Liability is not limited to those employees performing merely mechanical functions of collection and payment * * * but extends to all with responsibility and authority to avoid the default which constitutes a violation of the statute; even though more than one person may be liable. * * *

* * * * *

* * *. * * * an individual need not be in day to day control of the administrative and financial aspects of the business in order to be the responsible person within the meaning of Section 6672, so long as he has the right to control such aspects of the business.

Thus, even if Bua did have the duties which taxpayer claims, that fact is hardly determinative as to taxpayer's status. It is clear that any corporation may have more than the responsible person under Section 6672. Braden v. United States, 442 F. 2d 342 (C.A. 6, 1971), cert. denied sub nom. Bonistall v. Braden, 404 U.S. 912 (1971). Indeed, anyone who is aware of the fact that taxes were owing and nonetheless prefers other creditors is subject to liability under that section. Burack v. United States, 461 F. 2d 1282 (Ct. Cl., 1972). Taxpayer quite clearly falls within that description.

Of the \$11,500 used to purchase the corporation's accounts receivable, \$1,300 was paid to the Internal Revenue Service. (R. 11.) This amount was credited to the corporation's outstanding

balance of payroll tax liability for the quarter ended June 30, 1967. Taxpayer contends now, however, that this amount should be credited to his liability for the fourth quarter of 1967. (Br. 13.) What taxpayer fails to grasp, however, is that this would not reduce his total liability for he would then become liable for the balance of withholding taxes due for the second quarter of 1967. As we have shown, one is a responsible officer when he, knowing of tax arrearages, prefers other creditors over the United States. His responsibility (and his liability under Section 6672) extends to all those withholding tax arrearages of which he has knowledge and which, had he not preferred other creditors, he might have satisfied with corporate funds. Stake v. United States, supra. Thus the fact that \$1,300 was credited to one outstanding liability rather than another does not affect taxpayer's total liability as long as the credit was for a liability which arose prior to taxpayer's knowingly preferring creditors other than the United States.

Finally, the cases which taxpayer cites on brief are inapposite to the instant controversy. All the cases which he cites involve situations in which there were express findings that someone other than the taxpayer had preferred other creditors. As we have shown, those cases are not apposite here. Taxpayer here preferred other creditors over the United States and clearly was a responsible person within the meaning of Section 6672.

CONCLUSION

For the reasons stated above the judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

SCOTT P. CRAMPTON,
Assistant Attorney General,

GILBERT E. ANDREWS,
MICHAEL L. PAUP,
JEFFREY S. BLUM,
Attorneys,
Tax Division,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

PETER C. DORSEY,
United States Attorney,

HENRY S. COHN,
Assistant United States Attorney.

FEBRUARY, 1975.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing two copies thereof to each on this 3rd day of February, 1975, in envelopes, with postage prepaid, properly addressed to each of them, respectively, as follows:

Louis Noah Forman, Esquire
1540 Broadway
New York, New York 10036

Joseph Neiman, Esquire
103 Market Square
Newington, Conn. 06111

Gilbert E. Andrews/sch
GILBERT E. ANDREWS
Attorney

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 3102. DEDUCTION OF TAX FROM WAGES.

(a) Requirement.--The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.

* * *

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) [as amended by Sec. 101(a), Tax Adjustment Act of 1966, P.L. 89-368, 80 Stat. 38] Requirement of Withholding.--Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables. For purposes of applying such tables, the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in the table in subsection (b)(1):

* * *

SEC. 6671. RULES FOR APPLICATION OF ASSESSABLE PENALTIES.

* * *

(b) Person Defined.--The term "person", as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty therefor, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) General Rule.--Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

* * *